

MADISON WATER UTILITY

Madison, Wisconsin

**COMMUNICATION TO THOSE CHARGED
WITH GOVERNANCE AND MANAGEMENT**

As of and for the Year Ended December 31, 2015

MADISON WATER UTILITY

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**REQUIRED COMMUNICATION OF INTERNAL CONTROL RELATED MATTERS
IDENTIFIED IN THE AUDIT TO THOSE CHARGED WITH GOVERNANCE**

To the Water Utility Board
Madison Water Utility
Madison, Wisconsin

In planning and performing our audit of the financial statements of the Madison Water Utility as of and for the year ended December 31, 2015, in accordance with auditing standards generally accepted in the United States of America, we considered its internal control over financial reporting (internal control) as a basis for designing our auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of its internal control. Accordingly, we do not express an opinion on the effectiveness of its internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the following deficiency in Madison Water Utility's internal control to be material weaknesses, as further discussed on the following page:

- > Internal Control Over Financial Reporting
- > Financial Statement Restatement – Correction of Prior Period Error

As certain processes are combined with the municipality those systems were reviewed and control deficiencies, if any, reported as part of the municipality's overall audit. These include payroll, special assessments, information technology, and risk assessment.

This communication is intended solely for the information and use of management, those charged with governance, and others within the organization and is not intended to be, and should not be, used by anyone other than these specified parties.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
July 15, 2016

INTERNAL CONTROL OVER FINANCIAL REPORTING

Auditing standards require that we perform procedures to obtain an understanding of your government and its internal control environment as part of the annual audit. This includes an analysis of the utility's year-end financial reporting process and preparation of your financial statements.

A properly designed system of internal control allows for the presentation of year-end financial data and financial statements without material errors. At this time, the utility does not have internal controls in place that allow for the presentation of materially correct year-end financial statements. As a result, we consider this absence of controls to be a material weakness in internal control over the utility's financial reporting.

Our audit includes a review and evaluation of the utility's internal controls relating to financial reporting. Common attributes of a properly designed system of internal control for financial reporting are as follows:

- > There is adequate staffing to prepare financial reports throughout and at the end of the year.
- > Staff is properly trained and knowledgeable to perform all financial reporting functions.
- > Material misstatements are identified and corrected during the normal course of duties.
- > Complete and accurate financial statements including footnotes are prepared.
- > Financial reports are reviewed by an individual who is not the preparer for completeness and accuracy.

Our evaluation of the internal controls over financial reporting has identified control deficiencies that are considered material weakness surrounding the preparation of financial statements and footnotes, adjusting journal entries identified by the auditors, and an independent review of financial reports.

Management has not prepared financial statements that are in conformity with generally accepted accounting principles. In addition, material misstatements in the general ledger were identified during the financial audit. Management should consider what resources and changes are necessary to address and resolve the control deficiencies identified.

To provide some perspective, establishment of such internal controls can be a difficult task for governments. Many governments do rely on their auditors to prepare certain year-end adjusting entries and prepare the year-end financial statements. Because the auditors are not involved with the utility's day-to-day activities, it is important that management have the skills, knowledge, and experience to review the audit adjustments and financial statements prepared by the auditors to ensure completeness, accuracy, and consistency with management's knowledge of transactions impacting the utility during the year.

FINANCIAL STATEMENT RESTATEMENT – CORRECTION OF PRIOR PERIOD ERROR

The utility's internal controls over financial reporting should be designed to prepare financial statements in accordance with United States Generally Accepted Accounting Principles (GAAP). Subsequent discovery of material financial reporting errors and the required correction of previously issued financial statements indicate that a control broke down and therefore there is a material weakness in the utility's financial reporting system.

As described in Note 12 of the utility's 2015 financial statements, a restatement of the prior year financial statements was necessary to properly report expense activity for 2014 and 2013. The restatement also adjusted December 31, 2013 and December 31, 2014 net position balances as well. The proper internal controls were not in place at the utility to ensure that all activity was being properly reflected in the financial statements. A summary of the effects on the statements is included in Note 12.

OTHER COMMUNICATIONS TO THOSE CHARGED WITH GOVERNANCE

TWO WAY COMMUNICATION REGARDING YOUR AUDIT

As part of our audit of your financial statements, we are providing communications to you throughout the audit process. Auditing requirements provide for two-way communication and are important in assisting the auditor and you with more information relevant to the audit.

As this past audit is concluded, we use what we have learned to begin the planning process for next year's audit. It is important that you understand the following points about the scope and timing of our next audit:

- a. We address the significant risks of material misstatement, whether due to fraud or error, through our detailed audit procedures.
- b. We will obtain an understanding of the five components of internal control sufficient to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. We will obtain a sufficient understanding by performing risk assessment procedures to evaluate the design of controls relevant to an audit of financial statements and to determine whether they have been implemented. We will use such knowledge to:
 - > Identify types of potential misstatements.
 - > Consider factors that affect the risks of material misstatement.
 - > Design tests of controls, when applicable, and substantive procedures.

We will not express an opinion on the effectiveness of internal control over financial reporting or compliance with laws, regulations, and provisions of contracts or grant programs.

- c. The concept of materiality recognizes that some matters, either individually or in the aggregate, are important for fair presentation of financial statements in conformity with generally accepted accounting principles while other matters are not important. In performing the audit, we are concerned with matters that, either individually or in the aggregate, could be material to the financial statements. Our responsibility is to plan and perform the audit to obtain reasonable assurance that material misstatements, whether caused by errors or fraud, are detected.

We are very interested in your views regarding certain matters. Those matters are listed here:

- a. We typically will communicate with your top level of management unless you tell us otherwise.
- b. We understand that the utility and the board have the responsibility to oversee the strategic direction of your organization, as well as the overall accountability of the entity. Management has the responsibility for achieving the objectives of the entity.
- c. We need to know your views about your organization's objectives and strategies, and the related business risks that may result in material misstatements.
- d. Which matters do you consider warrant particular attention during the audit, and are there any areas where you request additional procedures to be undertaken?
- e. Have you had any significant communications with regulators or grantor agencies?
- f. Are there other matters that you believe are relevant to the audit of the financial statements?

Also, is there anything that we need to know about the attitudes, awareness, and actions of the utility concerning:

- a. The utility's internal control and its importance in the entity, including how those charged with governance oversee the effectiveness of internal control?
- b. The detection or the possibility of fraud?

TWO WAY COMMUNICATION REGARDING YOUR AUDIT (cont.)

We also need to know if you have taken actions in response to developments in financial reporting, laws, accounting standards, governance practices, or other related matters, or in response to previous communications with us.

With regard to the timing of our audit, here is some general information. Our final financial fieldwork is scheduled during the spring to best coincide with your readiness and report deadlines. After fieldwork, we wrap up our financial audit procedures at our office and may issue drafts of our report for your review. Final copies of our report and other communications are issued after approval by your staff. This is typically 6-10 weeks after final fieldwork, but may vary depending on a number of factors.

Keep in mind that while this communication may assist us with planning the scope and timing of the audit, it does not change the auditor's sole responsibility to determine the overall audit strategy and the audit plan, including the nature, timing, and extent of procedures necessary to obtain sufficient appropriate audit evidence.

We realize that you may have questions on what this all means, or wish to provide other feedback. We welcome the opportunity to hear from you.

**COMMUNICATION OF OTHER CONTROL DEFICIENCIES, RECOMMENDATIONS
AND INFORMATIONAL POINTS TO MANAGEMENT THAT ARE NOT
MATERIAL WEAKNESSES OR SIGNIFICANT DEFICIENCIES**

FINANCIAL RESULTS

The management discussion and analysis section of the utility's financial statements highlights financial and operating information useful to management. It contains an excellent discussion of the major financial and operational events for the year.

CURRENT YEAR COMMENTS AND RECOMMENDATIONS

DEBT COVERAGE REQUIREMENTS

The general debt covenant provisions of the utility's revenue bonds require the utility to maintain a debt coverage ratio of 1.25. During the year, the utility issued an additional \$41.6 million in revenue bonds which raised the funding requirement by approximately \$4 million beginning in 2016. As a result, the utility did not meet the debt coverage requirement for 2015. New water rates were placed into effect beginning in October 2015 which should reduce the shortfall. We recommend that the utility monitor their debt coverage requirement and account for this new issuance in order to stay in compliance with their bond agreement.

COMMUNICATION WITH OTHER DEPARTMENTS

The City of Madison completed a multi-year ERP implementation during the year which significantly changed various processes and transaction cycles. Several of the process changes impacted the water utilities operations. During the audit, we noted several instances where transactions and balances on the cities books did not equal that of the water utility. Staff and Baker Tilly time was spent reconciling and balancing the books of each entity with no formal process being used. We recommend the utility develop and communicate a systematic process for reconciling and balancing activity with other departments to ensure accurate financial reporting.

STATUS OF PRIOR YEAR COMMENTS AND RECOMMENDATIONS

PERIODIC REVIEW OF REVENUE AND CUSTOMER BILLINGS

Madison Water Utility implemented several changes to its billing and revenue recognition practices during July 2014. Prior to this date the utility billed customers (with the exception of very large users) bi-annually utilizing multiple billing cycles and also accrued for revenues earned but not yet billed until the following fiscal year. Billings were sent monthly dependent upon the timing of meter reads and billing cycles and consumption was measured in cubic feet of water sold. The change in July 2014 switched all utility customers to monthly billing and consumption measured in gallons. A true-up billing was completed in August to transition customers to the new practice.

During our review of the aforementioned changes to the utility's processes as part of our standard audit procedures, we experienced several difficulties in gaining comfort with recorded revenues for the year. These are explained in detail below.

- > We noted one of the utility's largest customers was billed for eleven months of revenue during 2014 and thirteen months in the previous year. This was the result of a conversion of the customer to a monthly billing process and timing differences from the prior year. An audit entry was recorded to recognize revenues in the correct period and also contributed to a restatement of the 2013 financial statements.

STATUS OF PRIOR YEAR COMMENTS AND RECOMMENDATIONS (cont.)

PERIODIC REVIEW OF REVENUE AND CUSTOMER BILLINGS (cont.)

- > Our review of the August true-up billings revealed that customers were over/under-billed as a result of not prorating the rate blocks during the conversion period. The error largely affected high volume users that were not previously billed on a monthly basis. The overall net effect on total revenues for the utility was determined to be immaterial, however, individual customers should be provided credits or additional billings accordingly.
- > Annual billing reports generated from the utility billing system were determined to be unreliable during our analysis. Monthly reports were run, summarized and compared to the annual reports with a high degree of variability between the two. A consumer analysis was performed using the monthly reports which more closely matched actual recorded revenues for each month and ultimately lead to the determination that the annual reports were not reliable. The inaccuracy of the reports made it difficult to analyze year to year fluctuations in billing data.
- > The monthly consumer analysis noted in the previous point consists of a detailed review of billing data and the recalculation of revenues to develop an expectation of anticipated revenues for each customer class. A moderate degree of variability is expected from month to month between each customer class as a result of changes in customers and usage patterns. Our review of the consumer analysis revealed that while total monthly and annual revenues were within expectations, the breakdown between the various customer classes was not, most notably the industrial and public authority classifications.

The changes that took place during the year were significant enough to require a thorough review of each process and change to ensure accurate customer billings and proper accounting treatment. We noted no such review took place by management during the year. Each of the points above should be individually addressed by management as additional changes to the process are anticipated for 2015 (i.e. integration with new accounting system and potential changes in rates). We recommend the following processes being implemented at the utility.

- > Complete a monthly consumer analysis to determine the reasonableness of revenue recorded vs. actual billings. This analysis should identify any inconsistencies in the revenue recognition throughout the year as well as the breakdown between customer classes.
- > Periodically recompute random customer billings from each customer class to ensure proper application of billing rates and customer classification. This process should especially be completed during periods when modifications to the billing system are experienced (i.e. rate changes, customer classification changes, true-up billings, etc.).
- > Our initial analysis included comparisons between volume sold, customer changes and actual revenue between years. This analytic analysis should be completed by the financial manager at least on an annual basis.

Status Update – 12/31/2015

At the end of fiscal 2015 the utility completed a thorough review of customer billings and revenues with no significant issues noted. We recommend the utility continue this practice on a monthly basis.

STATUS OF PRIOR YEAR COMMENTS AND RECOMMENDATIONS (cont.)

APPROACH TO FISCAL YEAR 2015

At the financial manager's request, we delayed our scheduled audit fieldwork to allow for the utility to have records ready for audit. The City of Madison has a very detailed timeline the audit is required to follow, including liquidated damages if Baker Tilly does not meet the deadlines. The audit is scheduled for the third week in April to allow enough time after year end to prepare while still providing adequate time for our completion and review of the audit before the audit team for the City needs the utility's information for inclusion in their citywide report. We have the following recommendations for the utility to consider allowing for a smoother process in 2015:

- > We recommended certain revenue analytics and reconciliations are prepared as discussed above.
- > Open work orders in Construction Work in Progress need to be reviewed for any items that may need to be expensed in the year the cost was incurred. This was the basis for one of the financial statement restatements during this year's audit.
- > The utility uses the account completed construction not classified to hold costs for projects that have been completed but the utility has not had the time to close them out to the proper primary plant accounts. Last year, we verbally recommended this account be properly closed out before the rate study was filed with the PSC since this holding account is only meant for use in temporary and rare situations to begin depreciating projects that have not been closed out. Instead of closing out this account in 2014, the balance grew to \$31,242,000 from \$13,667,000. We recommend this account be properly closed out to primary plant accounts in 2015.
- > Conversions to new accounting software are often very time consuming and often do not go as planned. An already stressful situation can be made worse by a lack of communication and planning. We learned from finance management that the utility believes it does not have an adequate chart of accounts established for the new accounting software. We also learned that reconciliations for 2015 were substantially behind, perhaps due to the conversion. It is critical that the chart of accounts concerns be addressed and any remaining conversion issues are cleared with the City as soon as possible. 2015 month end closing and reconciliations should be caught up to date as soon as possible as well.

We are available to assist the utility with any of these points as well as talking through other details to ensure 2015 financial records are complete, accurate and timely.

Status Update – 12/31/2015

It was noted during our 2015 audit that open work orders and monthly reconciliations were still not being closed on a timely basis. Audit fieldwork was delayed on several occasions as a result of untimely month-end closing processes and balancing with the city funds. We also noted that the utility closed out most of the completed construction not classified and construction work in progress accounts to primary plant accounts in 2015, as the balance dropped from \$31,242,000 to \$2,301,000, which lead to a restatement of both the beginning and ending 2014 net position. We also experienced a few issues associated with reconciling the accounts receivable balances during the year. Two accounting periods were open at the same time which lead to improper posting of cash receipts to the wrong month and fiscal year at the end of 2015. The transactions were immaterial, however, a break-down in controls lead to the occurrence. We continue to recommend the utility develop a timely month end closing process in the future.

STATUS OF PRIOR YEAR COMMENTS AND RECOMMENDATIONS (cont.)

REVIEW OF CUSTOMER ADVANCES

The utility collects customer advances for construction and meter projects. Once a project is complete, the utility will determine whether the customer advances related to the project should be recognized as revenue or a refund is given to the customer if the actual project costs were less than the advance received. It was noted that there are several customer advances received that date back to 2006, which could mean there are customer advances retained that are related to completed projects. We are recommending that the utility review customer advances to see if related projects are complete and whether the utility should recognize the advances related to completed projects as revenue or provide a refund to the customer.

Status Update – 12/31/2015

We noted during our testing that customer advances dating back to 2006 were removed from the account with refunds provided to the customer or revenue recognized for the completed projects. There are still several deposits dating back to 2008 that could be related to completed projects and we continue to recommend that the utility monitor these projects and recognize the advances related to completed projects as revenue or provide a refund to the customer.

EVALUATION OF PROPERTY HELD FOR FUTURE USE

Currently this balance represents tower and well sites, which are owned by the utility but not currently used during the course of operation. The listing of these projects are vague, in that there are no explanations on where the costs have come from, the expectations on when the projects will begin, what triggers the projects, and the evaluation process to ensure that the costs should not have been expensed. We are recommending that the utility review the current listing of properties that are being held for future use, and for each item provide an explanation describing the costs, when the project will begin, what triggers the project and the evaluation to describe why the costs are not being expensed.

Status Update – 12/31/2015

During the audit we noted that a more descriptive explanation was provided for each project. As mentioned in the prior year, this was done at the direction of the Public Service Commission of Wisconsin during the rate review process in 2014. We recommend the utility continue to monitor this account for proper accounting treatment. This point is considered cleared.

REVIEW OF WORK ORDER CLOSING PROCESS

The utility completes a significant amount of construction each year and as such the proper accounting for capital assets is a key area for the finance department. Costs including labor, materials, contractor charges and overheads are accumulated in a separate work order for each project. When the project is complete, finance obtains reports from engineering on the types of assets and quantities installed and removed. This is used to close the work order and record the assets in the detailed property accounts as required by the Public Service Commission of Wisconsin (PSCW). We recommend that the utility review the process of closing work orders and work with engineering to help in determining whether projects with open work orders have been placed in service and should be closed to capital assets.

In addition, work orders have also been closed to a temporary account called completed construction not classified. This account is depreciated on an annual basis but is meant as a temporary account. This account should be reviewed and properly classified before the utility intends to file the next water rate increase.

STATUS OF PRIOR YEAR COMMENTS AND RECOMMENDATIONS (cont.)

REVIEW OF WORK ORDER CLOSING PROCESS (cont.)***Status Update – 12/31/2015***

The utility made a lot of progress in 2015. As we anticipated, the software conversion was very time consuming. That, coupled with a change in personnel affected the timeline of when work orders were closed and account reconciliations occurred during the year which delayed audit fieldwork. The utility closed out most of the completed construction not classified and construction work in progress accounts to primary plant accounts in 2015 and the balance of unclassified work orders dropped from \$31,242,000 to \$2,301,000. The classification of those older completed projects led to a restatement of both the beginning and ending 2014 net position. We understand the utility has made efforts to ensure that work orders and account reconciliations are completed in a timely manner for 2016.

PROFESSIONAL STANDARDS UPDATE / INFORMATIONAL POINTS

INTERPRETING YOUR FINANCIAL STATEMENTS POST-GASB No. 68

Now that your financial statements reflect the requirements of GASB Statement No. 68, what has changed and how do you interpret this new information? In summary, GASB Statement No. 68 required governmental entities participating in the Wisconsin Retirement System (WRS) to report their proportionate share of the net pension asset of WRS as of a specific date along with their proportionate share of pension expenses incurred by the WRS for the period ending on that date. That date is referred to as the "Measurement Date". For WRS, this date was December 31, 2014 and annually thereafter.

As of December 31, 2014, WRS reported total resources available to provide pension benefits of \$92.1 billion. They also reported a total liability for pensions of \$89.7 billion. This resulted in a net pension asset of \$2.4 billion. This is the amount from which your proportionate share that is reported on your Statement of Net Position as a net pension asset is determined. This asset is not something that is convertible into cash or available to spend on other activities but rather will become part of your pension expense in future years on the Statement of Activities as it changes from one year to the next based on the activity of WRS. As such it is reported as a restricted long-term or non-current asset and is also reflected as restricted net position because it represents funds held in trust by the WRS that can only be used for the payment of pension benefits.

Additionally, there are other amounts classified as deferred outflows or inflows of resources related to the WRS that are now reported on your Statement of Net Position. These amounts reflect the differences in expected or projected results used by the actuary to determine the total pension liability versus the actual results obtained. The most prominent and volatile of these amounts is the difference between the projected earnings of the investments to the actual earnings of the investments. Depending upon market conditions, actual earnings on investments, which include changes in the market value of those investments, can change significantly from one year to the next. In order to smooth out the effects of these differences, these amounts reported as deferred outflows or inflows of resources are amortized to pension expense over a period of time (approximately 5 years).

PROFESSIONAL STANDARDS UPDATE / INFORMATIONAL POINTS (cont.)

INTERPRETING YOUR FINANCIAL STATEMENTS POST-GASB No. 68 (cont.)

One additional item reported as a deferred outflow of resources is required by this new standard. Any pension contributions (employer amounts and employee amounts paid by the employer) attributable to periods after the Measurement Date (December 31, 2014) are to be removed from the current year's pension expense and applied to the following year's pension expense on the Statement of Revenues, Expenses and Changes in Net Position.

Amounts reported as deferred outflows of resources increases your reported total net position. These amounts increase the reported unrestricted net position.

It should be noted that while these changes affect your proprietary fund financial statements, the implementation of this new standard does not affect how you fund or pay for your pension contributions to the WRS. The process of funding and paying these pension benefits remains unchanged.

The accounting and reporting of pensions has become more complex with the implementation of GASB Statement No. 68. Please contact your Baker Tilly professional to discuss or clarify how this new accounting standard affects your financial statement.

WISCONSIN ACT 274 IMPLEMENTATION

During 2013 the Wisconsin legislature passed Act 274 which revised the law applicable to residential tenants' delinquent utility charges. This legislation preserved the ability of municipal utilities to use the tax roll for collecting delinquent utility charges; however, there are some new requirements that the utility will need to comply with in order to utilize this collection method for residential tenant accounts. The requirements include additional disclosures and notifications to property owners (landlords). At this time, management should consider if the billing system can be used to enhance the efficiency of these notifications as well as the data required for amounts ultimately transferred to the tax roll. Additional information on this legislation can be found at http://www.lwm-info.org/vertical/sites/%7B92F7D640-E25A-4317-90AD-4976378A8F8D%7D/uploads/2013_Wisconsin_Act_274_FAQ_Packet.pdf.

CYBER RISK

Information security is a growing concern for many organizations and is no longer considered to be strictly an Information Technology (IT) issue. If your government is the victim of a security breach, the impacts can be financial, operational, and reputational. Cyber risk should be a high priority and evaluated on a regular basis.

Security breaches can come in a number of forms, which are constantly evolving with advances in and increased use of technology. It is important for governments to assess what types of information they have that would be vulnerable to cyber-attack. Does your organization process, collect, and/or store personal information about employees or customers? Information related to social security numbers, bank accounts, addresses, medical information, birth dates, and credit cards is common for governments. It is important to take inventory of all of the personal information that flows through your systems in order to properly secure your data.

PROFESSIONAL STANDARDS UPDATE / INFORMATIONAL POINTS (cont.)

CYBER RISK (cont.)

Certain types of personal information are required to be protected in prescribed ways. If you are required to comply with the Health Insurance Portability and Accountability Act (HIPAA) or Payment Card Industry Data Security Standards (PCI DSS), there should be a designated individual within management that should be familiar with and oversee compliance in these areas.

Outsourcing portions of your data processing can remove personal information from your system; however, outsourcing does not remove your responsibility for oversight of this data. If customer or employee data is hacked while with the third-party vendor, your organization can still be responsible. Certain vendors have a Statement on Standards for Attestation Engagements 16 report (SSAE 16 report) that provide you with information about that vendor's internal controls, including data security, and an independent assessment on whether those controls are effective. In addition, any vendors providing PCI DSS services for your organization should be able to provide a certificate of compliance annually upon request. There should be a designated individual within management that is responsible for monitoring information with a third-party service provider at least annually.

Finally, we recommend that you have an incident response plan developed and practiced so that you are prepared in the event of a data breach.

REQUIRED COMMUNICATIONS BY THE AUDITOR TO THOSE CHARGED WITH GOVERNANCE

To the Water Utility Board
Madison Water Utility
Madison, Wisconsin

Thank you for using Baker Tilly Virchow Krause, LLP as your auditor. We have completed our audit of the financial statements of the July 15, 2016. This letter presents communications required by our professional standards.

***OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED
IN THE UNITED STATES OF AMERICA***

The objective of a financial statement audit is the expression of an opinion on the financial statements. We conducted the audit in accordance with auditing standards generally accepted in the United States of America. These standards require that we plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements prepared by management with your oversight are free of material misstatement, whether caused by error or fraud. Our audit included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit does not relieve management or those charged with governance of their responsibilities.

As part of the audit we obtained an understanding of the entity and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing and extent of further audit procedures. The audit was not designed to provide assurance on internal control or to identify deficiencies in internal control.

OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

Our responsibility does not extend beyond the audited financial statements identified in this report. We do not have any obligation to and have not performed any procedures to corroborate other information contained in client prepared documents, such as official statements related to debt issues.

PLANNED SCOPE AND TIMING OF THE AUDIT

We performed the audit according to the planned scope and general timing previously communicated in our letter about planning matters dated August 25, 2015.

To the Water Utility Board
Madison Water Utility

QUALITATIVE ASPECTS OF THE ENTITY'S SIGNIFICANT ACCOUNTING PRACTICES

Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Madison Water Utility are described in Note 1 to the financial statements. During 2015, certain utility's 2013 and 2014 expenses have been restated to correct errors in previously reported in construction work in progress and revenues. A description of these restatements is included in Note 12 to the financial statements. As described in Note 1 to the financial statements, the utility changed accounting policies related to financial reporting for pensions by adopting Statement of Governmental Accounting Standards (GASB) Statement No. 68, *Accounting and Financial Reporting for Pension – an Amendment of GASB Statement No. 27* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – an Amendment of GASB Statement No. 68* in 2015. Accordingly, the accounting change has been reported as a cumulative effect of a change in accounting principle in 2015 since data necessary to restate 2014 was not available. We noted no other transactions entered into by the Madison Water Utility during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

Management's estimates of accrued sick leave and other postemployment benefit liabilities are based on a combination of historical data and possible future outcomes. We have reviewed the methodology for the accrued sick leave and the actuarial report for the other postemployment benefits and related assumptions in determining that it is reasonable in relation to the financial statements taken as a whole.

Management's estimate of the net pension asset and related deferrals are based on information provided by the Wisconsin Retirement System as audited by the Legislative Audit Bureau. We evaluated the key factors and assumptions used to develop the pension asset and related deferrals in determining that it is reasonable in relation to the financial statements taken as a whole.

Financial Statement Disclosures

The disclosures in the notes to the financial statements are neutral, consistent, and clear.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

During the audit we experienced difficulties with the timely receipt of audit support and delays in audit fieldwork due to lack of preparedness. The culmination of these events expanded the scope of work and extension of audit deadlines.

To the Water Utility Board
Madison Water Utility

CORRECTED MISSTATEMENTS

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. Please see the attached listing of all adjusting journal entries identified during the audit for further information.

DISAGREEMENTS WITH MANAGEMENT

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditors' report. No such disagreements arose during the course of our audit.

CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

In some cases, management may decide to consult with other accountants about auditing and accounting matters. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditors' opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter. This letter follows this required communication.

INDEPENDENCE

We are not aware of any relationships between Baker Tilly Virchow Krause, LLP and the Madison Water Utility that, in our professional judgment, may reasonably be thought to bear on our independence.

Relating to our audit of the financial statements of the Madison Water Utility for the year ended December 31, 2015, Baker Tilly Virchow Krause, LLP hereby confirms that we are, in our professional judgment, independent with respect to the Madison Water Utility in accordance with the Code of Professional Conduct issued by the American Institute of Certified Public Accountants. We provided no services to the Madison Water Utility other than audit services provided in connection with the audit of the current year's financial statements and nonaudit services which in our judgment do not impair our independence, including:

- > Financial statement preparation
- > Adjusting journal entries
- > Year-end closing assistance

None of these nonaudit services constitute an audit under generally accepted auditing standards, including *Government Auditing Standards*.

To the Water Utility Board
Madison Water Utility

OTHER AUDIT FINDINGS OR ISSUES

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as Madison Water Utility's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

OTHER MATTERS

We applied certain limited procedures to the required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

RESTRICTION OF USE

This information is intended solely for the use of those charged with governance and management and is not intended to be, and should not be, used by anyone other than these specified parties.

We welcome the opportunity to discuss the information included in this letter and any other matters. Thank you for allowing us to serve you.

Baker Tilly Vinchow Krause, LLP

Madison, Wisconsin
July 15, 2016

MANAGEMENT REPRESENTATIONS



**Madison
Water Utility**

119 East Olin Ave, Madison, WI 53713
608.266.4651 • madisonwater.org

July 15, 2016

Baker Tilly Virchow Krause, LLP
Ten Terrace Court
P.O. Box 7398 Madison, WI 53707-7398

Dear Baker Tilly Virchow Krause, LLP:

We are providing this letter in connection with your audit of the financial statements of the Madison Water Utility as of December 31, 2015 and 2014 and for the years then ended for the purpose of expressing an opinion as to whether the financial statements present fairly, in all material respects, the financial position of the Madison Water Utility and the respective changes in financial position and cash flows in conformity with accounting principles generally accepted in the United States of America. We confirm that we are responsible for the fair presentation of the previously mentioned financial statements in conformity with accounting principles generally accepted in the United States of America. We are also responsible for adopting sound accounting policies, establishing and maintaining internal control over financial reporting, and preventing and detecting fraud.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement. An omission or misstatement that is monetarily small in amount could be considered material as a result of qualitative factors.

We confirm, to the best of our knowledge and belief, the following representations made to you during your audit.

Financial Statements

1. We have fulfilled our responsibilities, as set out in the terms of the audit engagement letter.
2. The financial statements referred to above are fairly presented in conformity with accounting principles generally accepted in the United States of America. We have engaged you to advise us in fulfilling that responsibility. The financial statements include all properly classified funds of the utility required by accounting principles generally accepted in the United States of America to be included in the financial reporting entity.
3. We acknowledge our responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

control to prevent and detect fraud.

5. Significant assumptions we used in making accounting estimates, if any, are reasonable.
6. All events subsequent to the date of the financial statements and for which accounting principles generally accepted in the United States of America require adjustment or disclosure have been adjusted or disclosed. No other events, including instances of noncompliance, have occurred subsequent to the balance sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.
7. All material transactions have been recorded in the accounting records and are reflected in the financial statements.
8. All known audit and bookkeeping adjustments have been included in our financial statements, and we are in agreement with those adjustments.
9. There are no known or possible litigation, claims, and assessments whose effects should be considered when preparing the financial statements. There are no unasserted claims or assessments that our lawyer has advised us are probable of assertion and must be disclosed in accordance with accounting principles generally accepted in the United States of America.

Information Provided

10. We have provided you with:
 - a. Access to all information, of which we are aware, that is relevant to the preparation and fair presentation of the financial statements, such as financial records and related data, documentation, and other matters.
 - b. Additional information that you have requested from us for the purpose of the audit.
 - c. Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
 - d. Minutes of the meetings of Madison Water Utility Board or summaries of actions of recent meetings for which minutes have not yet been prepared.
11. We have disclosed to you results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
12. We have no knowledge of any fraud or suspected fraud that affects the entity and involves:
 - a. Management,
 - b. Employees who have significant roles in internal control, or
 - c. Others where the fraud could have a material effect on the financial statements.
13. We have no knowledge of any allegations of fraud or suspected fraud affecting the entity received in communications from employees, former employees, regulators, or others.
14. We have no knowledge of known instances of noncompliance or suspected noncompliance with provisions of laws, regulations, contracts, or grant agreements, or abuse, whose effects should

be considered when preparing financial statements.

15. There are no known related parties or related party relationships and transactions of which we are aware.

Other

16. There have been no communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.
17. We have taken timely and appropriate steps to remedy fraud, noncompliance with provisions of laws, regulations, contracts or grant agreements, or abuse that you have reported to us.
18. We have a process to track the status of audit findings and recommendations.
19. We have identified to you any previous financial audits, attestation engagements, and other studies related to the audit objectives and whether related recommendations have been implemented.
20. We have provided our views on reported findings, conclusions, and recommendations, as well as our planned corrective actions, for our report.
21. The Madison Water Utility has no plans or intentions that may materially affect the carrying value or classification of assets, liabilities, or equity.
22. We are responsible for compliance with federal, state, and local laws, regulations, and provisions of contracts and grant agreements applicable to us, including tax or debt limits, debt contracts, and IRS arbitrage regulations; and we have identified and disclosed to you all federal, state, and local laws, regulations and provisions of contracts and grant agreements that we believe have a direct and material effect on the determination of financial statement amounts or other financial data significant to the audit objectives, including legal and contractual provisions for reporting specific activities in separate funds.
23. There are no:
- a. Violations or possible violations of budget ordinances, federal, state, and local laws or regulations (including those pertaining to adopting, approving and amending budgets), provisions of contracts and grant agreements, tax or debt limits, and any related debt covenants whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency, or for reporting on noncompliance, except those already disclosed in the financial statement, if any.
 - b. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by accounting principles generally accepted in the United States of America.
 - c. Rates being charged to customers other than the rates as authorized by the applicable authoritative body.
 - d. Violations of restrictions placed on revenues as a result of bond resolution covenants such as revenue distribution or debt service funding.
24. In regards to the nonattest services performed by you listed below, we have 1) accepted all management responsibility; 2) designated an individual with suitable skill, knowledge, or

experience to oversee the services; 3) evaluated the adequacy and results of the services performed, and 4) accepted responsibility for the results of the services.

- a. Financial statement preparation
- b. Adjusting journal entries
- c. Year-end closing assistance

None of these nonattest services constitute an audit under generally accepted auditing standards, including *Government Auditing Standards*.


25. The Madison Water Utility has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged as collateral.
26. The Madison Water Utility has complied with all aspects of contractual agreements that would have a material effect on the financial statement in the event of noncompliance.
27. Components of net position (net investment in capital assets; restricted; and unrestricted) are properly classified and, if applicable, approved.
28. The Madison Water Utility has no derivative financial instruments such as contracts that could be assigned to someone else or net settled, interest rate swaps, collars or caps.
29. Provisions for uncollectible receivables, if any, have been properly identified and recorded.
30. Interfund, internal, and intra-entity activity and balances have been appropriately classified and reported.
31. Deposits and investment securities are properly classified as to risk, and investments are properly valued. Collateralization agreements with financial institutions, if any, have been properly disclosed.
32. Provision, when material, has been made to reduce excess or obsolete inventories to their estimated net realizable value.
33. Capital assets, including infrastructure and intangible assets, are properly capitalized, reported, and, if applicable, depreciated/amortized. Any known impairments have been recorded and disclosed.
34. We have appropriately disclosed the Madison Water Utility's policy regarding whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net position are available and have determined that net position were properly recognized under the policy.
35. We acknowledge our responsibility for the required supplementary information (RSI). The RSI is measured and presented within prescribed guidelines and the methods of measurement and presentation have not changed from those used in the prior period. We have disclosed to you any significant assumptions and interpretations underlying the measurement and presentation of the RSI.
36. With respect to the supplementary information, (SI):
 - a. We acknowledge our responsibility for presenting the SI in accordance with accounting principles generally accepted in the United States of America, and we believe the SI,

including its form and content, is fairly presented in accordance with accounting principles generally accepted in the United States of America. The methods of measurement and presentation of the SI have not changed from those used in the prior period, and we have disclosed to you any significant assumptions or interpretations underlying the measurement and presentation of the supplementary information.

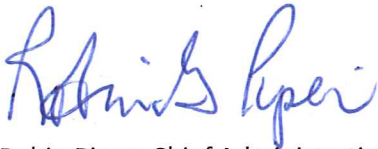
- b. If the SI is not presented with the audited financial statements, we will make the audited financial statements readily available to the intended users of the supplementary information no later than the date we issue the supplementary information and the auditor's report thereon.
- 37. We agree with the restatement presented in the current year's financial statements related to the implementation of GASB 68 and prior year expenses.
- 38. We assume responsibility for, and agree with, the information provided by the Wisconsin Retirement System as audited by the Legislative Audit Bureau relating to the net pension asset/liability and related deferred outflows and deferred inflows and have adequately considered the reasonableness of the amounts and disclosures used in the financial statements and underlying accounting records. We also assume responsibility for the census data that has been reported to the plan.

Sincerely,

Madison Water Utility



Tom Heikkinen, General Manager



Robin Piper, Chief Administrative Officer

AUDIT ADJUSTMENTS

Madison Water Utility
Year End: December 31, 2015
Adjusting Journal Entries
Date: 1/1/2015 To 12/31/2015
Account No: A01 To A99

TB. 2

Done By	In-Charge	Manager
Partner	Pre-issuance	JTS 6/14/2016
VH 6/19/2016		

Number	Date	Name	Account No	Reference	Annotation	Debit	Credit	Recurrence	Misstatement
A01	12/31/2015	Accrued Interest Expense	23700	LH. 2			81,644.00		
A01	12/31/2015	Interest on Long Term Debt	42700	LH. 2		81,644.00			
To adjust interest expense and accrued interest for 2010 BAB subsidy									
A02	12/31/2015	Other Deferred Credits-Sick	25300	LE. 1			19,431.00		
A02	12/31/2015	Other Deferred Credits-Sick	25300	LE. 1		12,533.00			
A02	12/31/2015	Other Deferred Credits-Vac	25301	LE. 1		19,431.00			
A02	12/31/2015	Other Deferred Crs - Comp Time	25302	LE. 1			12,533.00		
To adjust Compensated Absences for incorrect entry posting all amounts to Sick Leave instead of allocating amounts to all three accounts. (Do Note Replicate)									
A03	12/31/2015	CIP Completed not Classified	10600	H. 2. 2		620,722.00			
A03	12/31/2015	Construction Work in Progress	10700	H. 2. 2			620,722.00		
To reclassify 2015 work order activity between CWIP and CCNC									
A04	12/31/2015	Payables to City of Madison	23300				155,337.00		
A04	12/31/2015	Property Taxes	40800			155,337.00			
To adjust PILOT as beginning balances used in calculation were incorrect.									
A05	12/31/2015	RfD Meters	34609	H. W			33,929.00		
A05	12/31/2015	RfD Communications Equipment	39709	H. W		1,918.00			
A05	12/31/2015	Depreciation Expense	40300	H. W		32,011.00			
To record additional depreciation on meters and communication equipment for differences between GAAP and PSC.									
A06	12/31/2015	Def Outflow - Employer Contributions	17140	LH. X		549,299.00			
A06	12/31/2015	Restricted Net Pension Asset	18140	LH. X		2,171,084.00			
A06	12/31/2015	Restricted Net Postion - GASB 68	21603	LH. X			2,720,383.00		
GASB 68 - Entry to record beginning balances									
A07	12/31/2015	Def Outflow - Employer Contributions	17140	LH. X			549,299.00		
A07	12/31/2015	Def Outflow - Diff btwn prj and actual exprnc	17142	LH. X		197,014.00			
A07	12/31/2015	Def Outflow - Net dif btwn prj actl plan earn	17143	LH. X		658,101.00			
A07	12/31/2015	Restricted Net Pension Asset	18140	LH. X			812,069.00		
A07	12/31/2015	Def Inflow - Chgs and diff btwn emp ctrb	22605	LH. X			290.00		
A07	12/31/2015	Pension Expense - GASB 68	92601	LH. X		506,543.00			
Entry to record deferred outflows/inflows, pension expense and adjust net pension asset/liability.									
A08	12/31/2015	Def Outflow - Employer Contributions	17140	LH. X		528,068.00			
A08	12/31/2015	Pension Expense - GASB 68	92601	LH. X			528,068.00		
Entry to record employer pension payments subsequent to the measurement date									
A09	12/31/2015	Unappropriated Earned Surplus	21600	H. 2. 2		14,731.00			
A09	12/31/2015	Maintenance of Services	67500	H. 2. 2			14,731.00		
To restate prior year for expenses closed in 2015 related to 2014.									
A10	12/31/2015	Unappropriated Earned Surplus	21600	H. 2. 2		1,407,229.00			
A10	12/31/2015	Maintenance of Reservoirs	61200	H. 2. 2			3,187.00		
A10	12/31/2015	Maintenance of Wells	61400	H. 2. 2			201,232.00		
A10	12/31/2015	Maintenance of Buildings	63100	H. 2. 2			1,526.00		
A10	12/31/2015	Maint of Pumping Equipment	63300	H. 2. 2			81,673.00		
A10	12/31/2015	Maps & Records	66500	H. 2. 2			21,366.00		
A10	12/31/2015	Maintenance of Mains	67300	H. 2. 2			328,656.00		
A10	12/31/2015	Maintenance of Services	67500	H. 2. 2			675,373.00		

Madison Water Utility
Year End: December 31, 2015
Adjusting Journal Entries
Date: 1/1/2015 To 12/31/2015
Account No: A01 To A99

TB. 2-1

Done By	In-Charge	Manager
Partner VH 6/19/2016	Pre-issuance	JTS 6/14/2016

Number	Date	Name	Account No	Reference	Annotation	Debit	Credit	Recurrence	Misstatement
A10	12/31/2015	Maint of Hydrants	67700	H. 2.	2		53,348.00		
A10	12/31/2015	Maint of Distribution Reservoirs	67800	H. 2.	2		40,868.00		
To restate prior year for expenses closed in 2015 related to 2013 and prior.									
A11	12/31/2015	Cash in Bank	13100	D. 1			27,181.38		
A11	12/31/2015	Payables to City of Madison	23300	D. 1		27,181.38			
To adjust due to the city to a reduction in commingled cash (interest on advance).									
A12	12/31/2015	Due from Sanitary SewerUtility	14530	D. 1		81,256.91			
A12	12/31/2015	Due from Sanitary SewerUtility	14530	D. 1					
A12	12/31/2015	Due from Storm Water Utility	14540	D. 1		30,870.13			
A12	12/31/2015	Due from Storm Water Utility	14540	D. 1					
A12	12/31/2015	Misc General Expense	93000	D. 1			112,127.04		
A12	12/31/2015	Misc General Expense	93000	D. 1					
To record estimate to actual adjustment for 2014 relating to shared costs billed to the sewer/storm utility.									
A13	12/31/2015	Cash in Bank	13100	D. 1			155,337.00		
A13	12/31/2015	Payables to City of Madison	23300	D. 1		155,337.00			
To reclass audit entry for PILOT from a "due to the city" to a reduction of commingled cash.									
A14	12/31/2015	Cash in Bank	13100	D. 1		9,409.39			
A14	12/31/2015	Maintenance of Buildings	63100	D. 1			9,409.39		
To record insurance proceeds for damage to a booster pump that was transferred in from the insurance fund during 2015.									
A15	12/31/2015	Cash in Bank	13100	A. 1			20,538.77		
A15	12/31/2015	Misc General Expense	93000	A. 1		20,538.77			
To bring commingled cash in line with the City's balance.									
						7,280,258.58	7,280,258.58		
Net Income (Loss)			(165,267.39)						